



STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION

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TIMOTHY W. BOYER
Interim Executive Director

June 6, 2003

Dear Interested Party:

Enclosed is the *Initial Discussion Paper on Regulation 1628, Transportation Charges*. Discussion regarding proposed amendments to Regulation 1628 is scheduled for the Board's October 15, 2003 **Business Taxes Committee** meeting.

However, before the issue is presented at the Business Taxes Committee meeting, staff would like to provide interested parties an opportunity to discuss the issue and present any suggested changes or comments. Accordingly, a meeting is scheduled in **Room 122 at 9:00 a.m. on June 27, 2003**, at the Board of Equalization; 450 N Street; Sacramento, California. (Please note, the meeting time, originally scheduled for 10:00 a.m., has been changed.)

If you are unable to attend the meeting but would like to provide input for discussion at the meeting, please feel free to write to me at the above address or send a fax to (916) 322-4530 before the June 27 meeting. If you are aware of other persons that may be interested in attending the meeting or presenting their comments, please feel free to provide them with a copy of the enclosed material and extend an invitation to the meeting. If you plan to attend the meeting on June 27, or would like to participate via teleconference, I would appreciate it if you would let staff know by contacting Todd MacMurray at 916-324-2900 or by e-mail at todd.macmurray@boe.ca.gov prior to June 19, 2003. This will allow staff to make alternative arrangements should the expected attendance exceed the maximum capacity of Room 122 and to arrange for teleconferencing. In addition, please let Todd MacMurray know if you wish to have future correspondence, including the second discussion paper and all attachments, sent to your e-mail address rather than to your mailing address.

Whether or not you are able to attend the above interested parties' meeting, please keep in mind that the due date for interested parties to provide written preliminary responses to staff's analysis is **July 15, 2003**. Please be aware that a copy of the material you submit may be provided to other interested parties. Therefore, please ensure your comments do not contain confidential information.

If you are interested in other topics to be considered by the Business Taxes Committee, you may refer to the "Board Meetings and Committee Information" page on the Board's Internet web site (<http://www.boe.ca.gov/meetings/meetings.htm#two>) for copies of Committee discussion or issue papers, minutes, a procedures manual and calendars arranged according to subject matter and by month.

Thank you for your consideration. I look forward to your comments and suggestions. Should you have any questions, please feel free to contact me at (916) 324-1825.

Sincerely,

Charlotte Paliani
Program Planning Manager
Sales and Use Tax Department

CP: tdm

Enclosures

cc: (all with enclosures)
Honorable Carole Migden, Chairwoman
Honorable Claude Parrish, Vice Chairman
Honorable Bill Leonard, Member, Second District (MIC 78)
Honorable John Chiang, Member, Fourth District
Honorable Steve Westly, State Controller
Ms. Carole Ruwart, Board Member's Office, First District (MIC 71)
Ms. Sabina Crocette, Board Member's Office, First District
Mr. Neil Shah, Board Member's Office, Third District (via e-mail)
Mr. Romeo Vinzon, Board Member's Office, Third District (via e-mail)
Mr. Matthew Zylowski, Board Member's Office, Third District
Ms. Margaret Pennington, Board Member's Office, Second District (MIC 78)
Mr. Lee Williams, Board Member's Office, Second District (via e-mail)
Mr. Tim Treichelt, Board Member's Office, Second District (via e-mail)
Mr. John Thiella, Board Member's Office, Fourth District (MIC 72)
Ms. Marcy Jo Mandel, State Controller's Office
Mr. Timothy Boyer (MIC 83)
Acting Chief Counsel (MIC 83)
Mr. Ramon J. Hirsig (MIC 43)
Ms. Janice Thurston (MIC 82)
Mr. Warren Astleford (MIC 82)
Ms. Sharon Jarvis (MIC 82)
Mr. Robert Tucker (MIC 82)
Ms. Jean Ogrod (via e-mail)
Mr. Jeff Vest (via e-mail)
Mr. David Levine (MIC 85)
Mr. Steve Ryan (via e-mail)
Ms. Jennifer Willis (MIC 70)
Mr. Dave Hayes (MIC 67)
Mr. Joseph Young (via e-mail)
Mr. Vic Anderson (MIC 40 and via e-mail)
Mr. Larry Bergkamp (via e-mail)
Mr. Geoffrey E. Lyle (MIC 50)
Ms. Laureen Simpson (MIC 50)
Mr. Todd MacMurray (MIC 50)
Ms. Laura Jonoubai (MIC 50)

INITIAL DISCUSSION PAPER

Proposed Regulatory Change Regarding Reporting Tax on Delivery and Handling Charges Based on an Alternate Method

Regulation 1628, *Transportation Charges*

Issue

Should Regulation 1628, *Transportation Charges*, be amended to provide retailers the option to report nontaxable transportation charges using estimated transportation charges developed from a test, rather than reporting the transportation charges on an actual basis?

Background

Current Method of Accounting for Transportation Charges

Tax does not apply to “separately stated” charges for transportation of tangible personal property from the retailer’s place of business, or other point from which shipment is made “directly to the purchaser,” provided the transportation is by other than facilities of the retailer, such as by United States mail, independent contract or common carrier and provided the property is not sold for a “delivered price.” (Revenue and Taxation Code (RTC) sections 6011(c)(7), 6012(c)(7); Reg. 1628(a).) Transportation charges are separately stated only if they are separately set forth in the contract for sale or in a document reflecting that contract, issued contemporaneously with the sale, such as the retailer’s invoice. (Reg. 1628(a).) The retailer may only exclude the actual cost of the transportation. (Ibid.) To be entitled to the exclusion, the retailer must retain records showing the actual cost of transportation for each transaction. If transportation is by facilities of the retailer, the retailer may only exclude a reasonable charge for its transportation from the measure of tax. (Reg. 1628(b)(2).) When transportation is by facilities of the retailer or where the property is sold for a delivered price,¹ tax applies to charges for transportation to the purchaser, unless (1) the transportation charges are separately stated, (2) are for transportation from the retailer’s place of business or other point from which shipment is made directly to the purchaser, and (3) the transportation occurs after the sale of the property is made to the purchaser. (Ibid.)

Interested Party Proposal

Mr. Ernest J. Dronenburg of Deloitte and Touche (Deloitte) submitted a proposal for consideration by staff and discussion at the October 15, 2003, Business Taxes Committee meeting (see Exhibit 1 for a copy of Deloitte’s proposal). The proposal seeks to amend Regulation 1628 by adding subdivision (d), which would authorize the following:

- Providing retailers the option to report transportation charges using an estimate of the transportation charges developed from a test of the charges;

¹ Property is sold for a delivered price when the price agreed upon in the contract for sale includes whatever cost or charge may be made for transportation of the property directly to the purchaser. (Reg. 1628(b)(1).)

INITIAL DISCUSSION PAPER

Proposed Regulatory Change Regarding Reporting Tax on Delivery and Handling Charges Based on an Alternate Method

Regulation 1628, *Transportation Charges*

- Requiring the retailer to test transportation charges for one quarter on an actual basis (the retailer would then use the results of the one quarter test to estimate transportation charges for the subsequent three quarters);
- Requiring retailers to perform a new test annually; and
- Requiring Board audit staff annually (if requested by the retailer) to review the test procedures used and, if approved by staff, provide the retailer with written advice authorizing the use of the estimate of transportation charges. This written advice would serve as a basis for relief from additional taxes, penalties, and interest, as provided in RTC section 6596, in the event the estimate overstates or understates the transportation charges and results in additional taxes due or a refund.

Related Proposal—Business Taxes Committee Meeting of June 1998

In 1998, a tax practitioner proposed that Regulation 1628, *Transportation Charges*, be amended to allow an optional method of accounting for nontaxable transportation charges. Under that proposal, the total aggregate cost of transportation billed by independent carriers would be excluded from the measure of tax to the extent that it did not exceed the total aggregate amount of transportation costs billed by the retailer to its customers within a quarterly period. (See Exhibit 2 for a copy of the 1998 issue paper concerning that proposal.)

This proposal was discussed at the June 23, 1998 Business Taxes Committee (BTC) meeting. The BTC decided not to recommend authorization of the proposed optional method of accounting for transportation charges, as this required an amendment to RTC sections 6011 and 6012. The BTC encouraged industry representatives to draft proposed legislation to amend the statutory language. The BTC recommended that the Board support in concept legislation that would provide a statutory basis for allowing such an exclusion for delivery charges. To staff's knowledge, industry did not draft proposed legislation to amend the statutory language. (See Exhibit 3 for a copy of the 6/23/98 BTC meeting minutes.)

Discussion

Generally, taxpayers are allowed to calculate their taxable measure by any means they deem appropriate to accurately report their sales and use tax liability. However, if taxpayers calculate their nontaxable transportation charges based on historical data or some other method, the taxpayers risk that an audit of their records may uncover an overstatement (or understatement) of reported nontaxable transportation charges when compared to actual transportation charges.

INITIAL DISCUSSION PAPER

Proposed Regulatory Change Regarding Reporting Tax on Delivery and Handling Charges Based on an Alternate Method

Regulation 1628, *Transportation Charges*

As stated above, when property is transported by other than facilities of the retailer, only the actual cost of transportation may be excluded from the measure of tax. This is required by statute. (RTC sections 6011(c)(7), 6012(c)(7).) Staff interprets this to mean that an average, or estimated, cost cannot be used to calculate the exclusion for transportation charges since the amount of transportation charges excluded from the measure of tax shall not exceed the actual cost of the transportation to the retailer on a transaction by transaction basis. To the extent that an estimate for the transportation charge is more or less than the actual cost of transportation charged to a specific customer, this proposed amendment in some instances sanctions the collection of excess tax or excess tax reimbursement from the customer. Furthermore, as provided by Regulation 1700, *Reimbursement for Sales Tax*, excess tax reimbursement collected from one customer cannot be used to offset the liability for tax from another customer.

Summary

Deloitte proposes to amend Regulation 1628 to authorize retailers the option of reporting transportation charges using an estimate of the cost of transportation. This proposal is contrary to current law, which requires separately stated charges of the actual costs for transportation by other than facilities of the retailer, or separately stated charges not exceeding a reasonable charge for transportation by facilities of the retailer. It would be contrary to law for retailers to be allowed to offset their overcharge of tax or tax reimbursement for delivery to one customer against undercharge of tax or tax reimbursement for delivery to another customer. As was noted in the June 1998 proposal, such a change to reporting the exclusion of transportation charges would require legislation.

Staff welcomes suggestions from parties affected by these proposed revisions to Regulation 1628.

Prepared by the Program Planning Division, Sales and Use Tax Department

Current as of 06/3/03

Regulation 1628. Transportation Charges.

Reference: Sections 6010.5, 6011, 6012, Revenue and Taxation Code.

(a) Transportation by Carrier. Except as provided in paragraph (c) below, in the case of a sale, whether by lease or otherwise, tax does not apply to "separately stated" charges for transportation of property from the retailer's place of business or other point from which shipment is made "directly to the purchaser," provided the transportation is by other than facilities of the retailer, i.e., by United States mail, independent contract or common carrier. The place where the sale occurs, i.e., title passes to the customer or the lease begins, is immaterial, except when the property is sold for a delivered price or the transportation is by facilities of the retailer, as explained in (b) below. The amount of transportation charges excluded from the measure of tax shall not exceed the cost of the transportation to the retailer.

Transportation charges will be regarded as "separately stated" only if they are separately set forth in the contract for sale or in a document reflecting that contract, issued contemporaneously with the sale, such as the retailer's invoice. The fact that the transportation charges can be computed from the information contained on the face of the invoice or other document will not suffice as a separate statement. If a separately stated charge is made designated "postage and handling" or "shipping and handling", only that portion of the charge which represents actual postage or actual shipment may be excluded from the measure of tax. Such amounts may be excluded from the measure of tax even though such amounts are not affixed to, or noted on, the package. A separately stated charge designated "handling" or "handling charge" is not a separate statement of transportation charges. Tax applies to such charges, notwithstanding the fact that postage or shipment charges may or may not be affixed to or noted on the package.

Property will not be considered delivered "directly to the purchaser" if it is shipped to the retailer, to the retailer's agent or representative, or to anyone else acting in the retailer's behalf. Any separately stated charges by the retailer for the transportation of property to, rather than from, the retailer's place of business, or to another point from which the property will then be "delivered directly to the purchaser," are included in the measure of tax. Such charges represent incoming freight and are taxable as part of the cost of the property sold by the retailer.

(b) Transportation by Retailer's Facilities or Property Sold for Delivered Price.

(1) Definition. "Delivered Price." Property is sold for a delivered price when the price agreed upon in the contract for sale includes whatever cost or charge may be made for transportation of the property directly to the purchaser. A sale for a "guaranteed price" including a separately stated amount for transportation is a sale for a "delivered price." Property is not sold for a delivered price when the price is agreed upon and to this price is added a separately stated amount representing the cost or charge for transportation of the property directly to the purchaser and any increase or decrease in the actual cost of transportation is borne by or credited to the purchaser.

(2) In General. Except as provided in paragraph (c) below, when transportation is by facilities of the retailer or the property is sold for a delivered price, tax applies to charges for transportation to the purchaser, unless (A) the transportation charges are separately stated, (B) are for transportation from the retailer's place of business or other point from which shipment is made directly to the purchaser, and (C) the transportation occurs after the sale of the property is made to the purchaser. When the sale occurs before the transportation to the purchaser commences, the tax does not apply to separately stated charges for the transportation. The amount that may be excluded from the measure of the tax cannot exceed a reasonable charge for transportation by facilities of the retailer or the cost of transportation by other than facilities of the retailer.

(3) Determination of When Sale Occurs.

(A) Security Agreements. When a sale is made pursuant to a security agreement in which the retailer retains the title as security for the payment of the price, the sale occurs when possession of the property is transferred by the retailer to the purchaser or other person at the purchaser's direction.

(B) Leases. When the sale is by lease, the sale occurs upon the transfer of possession or granting of the right of possession of the property by the lessor to the lessee or other person at his direction.

(C) Sale on Approval. When the sale is on approval, the sale does not occur until the purchaser accepts the property.

(D) Other Sales. Unless explicitly agreed that title is to pass at a prior time, the sale occurs at the time and place at which the retailer completes his performance with reference to the physical delivery of the property, even though a document of title is to be delivered at a different time or place. If the contract requires or authorizes the retailer to send the property to the purchaser but does not require him to deliver it at destination, the retailer completes his performance with reference to the physical delivery of the property at the time and place of shipment, e.g., delivery of the property to a carrier for delivery by the carrier to the purchaser; but if the contract expressly requires delivery at destination, including cases where one of the terms of the contract is F.O.B. place of destination, the retailer completes his performance with reference to the physical delivery of the property on tender to the purchaser there. When delivery of the property is by facilities of the retailer, title passes when the property is delivered to the purchaser at the destination unless there is an explicit written agreement executed prior to the delivery that title is to pass at some other time.

(4) Place of Sale. For the purposes of the State Sales and Use Tax Law (but not for the purposes of the Bradley-Burns Uniform Local Sales and Use Tax Law nor for the purposes of the Transactions and Use Tax Law) the place of the sale or purchase of tangible personal property is the place where the property is physically located at the time the act constituting the sale or purchase takes place.

(c) Transportation of Landfill Material. Operative January 1, 1989, tax does not apply to separately stated charges for transportation of landfill material, e.g., sand, dirt or gravel, removed from the ground and transported from the excavation site to a landfill site specified by the purchaser if:

(1) the amount of transportation charges excluded from the measure of tax does not exceed a reasonable charge for transportation by facilities of the retailer or the cost of the transportation by other than facilities of the retailer, or

(2) the consideration received is solely for the purpose of transporting the material to a specified site and the material is transferred without charge. If such transportation charges are in excess of a reasonable charge for transportation by facilities of the retailer or in excess of the cost of the transportation by other than facilities of the retailer, the provisions of this paragraph will not apply.

For purposes of this paragraph, it is immaterial when title passes to the purchaser of the landfill material.

(d) Safe Harbor for Estimated Transportation Charges.

If transportation charges would qualify to be exempt under (a) above, except that the amount separately stated is an estimate by the retailer, at the retailer's expense they may report on a percentage of error basis if they follow the formula:

- 1) Develop an error percentage from a test of the amounts, which exceed the actual cost of the transportation to the retailer over the total transportation charges. This test, which would be done annually, must follow the same general methods used in a normal BOE audit of this item, i.e.: amounts must be tested on a transaction by transaction basis.
- 2) The succeeding period base is then evaluated to determine if there are any expected material changes in the transportation charges base from the facts and circumstances surrounding the base tested.
- 3) Then the percentage error, as determined in (1) above, is applied against the amount of transportation charges per the records and the sum is reported as additional gross receipts. The parameters of base used for the initial test must be the same as the ones that will apply to the reporting base. This computation is done for one quarter. After a period of one year a retest must be done.
- 4) The BOE shall verify the methods used and the amount reported in the normal three-year audit cycle. The Safe Harbor will apply on test-by-test bases. At the retailer's request the BOE will review the test procedure at the time the test is undertaken and give the retailer Sec. 6596 protection on a real time basis for that test.

APPENDIX

(a) Examples of Contract for Delivered Price.

- (1) The contract for sale provides for the sale of property for \$100 per unit delivered to the purchaser.

(2) The contract for sale provides for the sale of property for \$100 per unit "which includes cost of delivery at \$10 per unit."

(3) The contract for sale provides for the sale of property for \$100 per unit delivered, freight prepaid.

(4) The contract for sale provides for the sale of property for \$100 per unit freight collect and allowed.

(5) The contract for sale calls for the sale of property for a guaranteed price of \$100 consisting of \$90 plus \$10 freight.

(b) Examples of Contracts Which Are Not for a Delivered Price.

(1) The contract for sale provides for the sale of property for \$100 per unit freight collect.

(2) The contract for sale provides for the sale of property for \$100 per unit actual freight prepaid and added to the sales price.

(c) Examples of Application of Tax. All deliveries are by independent carrier. All billings are in accordance with the terms of the contract.

(1) The contract for sale provides for the sale of property for \$100 per unit delivered to the purchaser with freight prepaid.

Tax applies to sales price of \$100 per unit with no deduction for freight charge since the freight charges are not separately stated. The contract is for a delivered price and requires delivery to the purchaser. Title does not pass to the purchaser prior to delivery.

(2) Contract for sale provides for the sale of property for \$100 per unit. The retailer is required to ship the property to the purchaser freight collect.

Tax applies to \$100 per unit since the responsibility for the payment of the freight is upon the purchaser, and the seller makes no charge for freight. Since the carrier will bill the purchaser for the actual freight charge, there will be a separate statement of the freight. The property is not sold for a delivered price.

(3) The contract for sale provides for the sale of property for \$100 per unit freight collect and allowed. The measure of tax is \$100 per unit less the amount of the freight paid to the carrier and shown on the payment voucher sent to the retailer by the purchaser.

The sale is for a delivered price. Separately stated transportation charges are excludable from the measure of tax since the transportation occurred after the sale of the property. If the contract for sale explicitly provided for passage of title upon delivery to the destination, then the measure of tax would be \$100 per unit since the sale was for a delivered price and title did not pass prior to transportation.

(4) The contract for sale provides for the sale of property for \$100 per unit plus actual freight of \$10 per unit. Any increase or decrease in the freight is for the account of the buyer.

Tax applies to \$100 per unit since the contract is not for a delivered price and shipment is by independent carrier.

(5) The contract for sale provides for the sale of property for \$100 plus freight of \$10, and the seller guarantees the price will not exceed \$110.

Tax applies to \$100 because the sale is for a delivered price and there is no showing that title was to pass upon delivery at the destination. A contract will be construed as a shipment contract unless it expressly requires delivery at destination point. If the contract for sale explicitly provided for passage of title upon delivery to the destination, then the measure of tax would be \$110 since the sale was for a delivered price and title did not pass prior to transportation.

(6) The contract for sale provides for the sale of property for \$100 per unit freight equalized with x city. The invoice shows 10 units at \$100 per unit, \$1,000, freight from x city \$100, total \$1,100.

Under these circumstances, tax applies to \$1,000 since the only separate statement of freight is the freight equalized with x city in the amount of \$100. If the actual freight paid to the carrier for the transportation of the property from the retailer's place of business or other point from which shipment is made directly to the purchaser is less than \$100, the exclusion will be limited to the amount paid to the carrier.

(7) Assuming the same facts as above, except the invoice shows 10 units at \$100 per unit, \$1,000, freight equalized with x city \$100, total \$1,100. The invoice also shows the notation, "Actual freight prepaid from point of shipment to destination is \$200."

The sale is not for a delivered price. On the basis of the above billing, a separate statement of freight is made in the amount of \$200. Accordingly, the measure of tax is \$1,100 minus \$200, or \$900.

History: Adopted June 20, 1962, effective July 3, 1962.

Amended August 8, 1962.

Amended September 2, 1965.

Amended by renumbering November 3, 1971, effective December 3, 1971.

Amended November 11, 1971, effective December 16, 1971.

Amended October 11, 1984, effective December 13, 1984. In (a) deleted former second sentence and added last paragraph. Completely revised (b) (3) (D) and examples (c) (3) and (c) (5).

Amended April 5, 1989, effective June 21, 1989. Amended to provide that a charge for the transportation of landfill from an excavation site to a site specified by the purchaser of the landfill is exempt from the tax if the charge is separately stated and does not exceed a reasonable charge or if the entire consideration consists of payment for transportation.

Amended February 8, 1995, effective July 19, 1995. Amended subdivision (a) to reflect that where a separately stated charge is designated "postage and handling" or "shipping and handling," the exact amount of postage or shipping charges need not be affixed to the package but that such a charge marked "handling" is not a separate statement of transportation charges. Amended subdivisions (b)(2) & (3) to correct cross references in the California Code of Regulations.

Issue Paper Number 98-016

**BOARD OF EQUALIZATION**
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(Rev. 10-97)

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STATE OF CALIFORNIA
BOARD OF EQUALIZATION

REGULATION 1628, TRANSPORTATION CHARGES

APPLICATION OF TAX TO DELIVERY CHARGES

I. Issue

Should Regulation 1628, Transportation Charges, be amended to allow retailers the option to exclude from taxable revenue the aggregate amounts paid to independent carriers for delivery charges, on a quarterly basis, in lieu of accounting for deductible transportation charges on a transaction by transaction basis?

II. Staff Recommendation

It is the staff's recommendation that no changes be made to the current interpretation of Regulation 1628 as it applies to the statutory exemption for transportation charges. Under current statutes, Sales and Use Tax transactions are accounted for on a transaction by transaction basis; therefore, overcharges for delivery to one customer are not offset against undercharges for delivery to another customer to determine the correct measure of tax. To deviate from current practice would be to place the convenience of the retailer ahead of the interest of the consumer.

III. Other Alternative(s) Considered

Amend Sales and Use Tax Regulation 1628, Transportation Charges, to allow retailers the option to deduct the aggregate transportation charges billed by independent carriers during a quarterly period. If the retailer chooses this option, tax would be due on the excess of billed transportation charges to customers over the aggregate cost of transportation within the quarter.

IV. Background

In a petition heard at the November 13, 1996 Board meeting, the Board held that: (1) for each delivery, any portion of the delivery charge which exceeds the actual cost of delivery is subject to tax; and, (2) overcharges on one transaction cannot be offset by undercharges on another transaction. Subsequent to this Board decision, a tax practitioner proposed that Regulation 1628, Transportation Charges, be amended to allow an optional method of accounting for such charges. The practitioner proposed that the total aggregate cost of transportation billed by independent carriers be excluded from the measure of tax to the extent that it did not exceed the aggregate amount of transportation costs billed by the retailer to their customers within a quarterly period. Here the interest of the consumer and the duty of the Board to the consumer under the *Decorative Carpets, Inc.*¹ case conflicts with the convenience of the retailer.

Current Method of Accounting for Transportation Charges

Section 6012(c)(7) states that “Gross Receipts” do not include any of the following:

(7) Separately stated charges for transportation from the retailer’s place of business or other point from which shipment is made directly to the purchaser, but the exclusion shall not exceed a reasonable charge for transportation by facilities of the retailer or the cost to the retailer of transportation by other than facilities of the retailer. However, if the transportation is by facilities of the retailer, or the property is sold for a delivered price, this exclusion shall be applicable solely with respect to transportation which occurs after the sale of the property is made to the purchaser.

Revenue and Taxation Code section 6012(c)(7) has been interpreted to mean that the cost of transporting the property sold is not deductible from gross receipts unless certain requirements are satisfied. To be deductible, transportation charges must: (a) be separately stated; (b) for transportation directly to the purchaser; (c) not exceed the cost to the retailer of transportation by other than facilities of the retailer; and, (d) the sale must occur prior to delivery to the customer.

With regard to separately stated delivery charges by facilities other than those of the retailer, i.e., independent carriers, the Board’s interpretation of section 6012, as defined in Regulation 1628, has been that for each delivery, any portion of the delivery charge which exceeds the retailer’s cost is includable in taxable gross receipts. Therefore, only the actual cost of delivery is excludable from taxable gross receipts measured on a transaction by transaction basis.

¹ *Decorative Carpets, Inc. v. State Board of Equalization* (1962) 58 Cal. App. 2d 252.

Discussion of Issue:

The proposed aggregate method for deducting transportation charges represents a significant departure from the current statutory requirement of section 6012.

Under this proposal, the retailer would be allowed a deduction for all amounts paid to independent carriers regardless of whether the separately stated charges for transportation to the customer were higher, equal to, or less than the actual transportation cost charged by independent carriers on individual transactions. If the aggregate transportation charges billed to customers were higher than the transportation cost billed by independent carriers, the excess would be required to be included in taxable gross receipts.

The following two tables illustrate how the current and proposed method for deducting transportation charges would apply under two different scenarios:

Table 1 Transportation Charges 1Q – 19XX

(A)	(B)	(C)	(D)
Transaction	Billed Amount	Actual Cost	Excludable
1	\$10	\$ 5	\$ 5
2	\$10	\$15	\$10
3	\$10	\$10	\$10
Total	<u>\$30</u>	<u>\$30</u>	<u>\$25</u>

Current Method

Assuming the transactions in Table 1 qualify as deductible transportation charges under Regulation 1628, the measure of tax to be excluded for the quarter would be \$25. This amount represents the lower of the billed transportation charge to the customer, or the actual cost of transportation on a transaction by transaction basis. The \$5 excess of billed charges over actual transportation costs on transaction 1 is not deductible and would be considered taxable gross receipts.

Proposed Method

Under the proposed method of aggregating transportation costs against billed amounts, the excludable amount of transportation charges in Table 1 would be \$30. This method allows the retailer to use quarterly transportation totals instead of calculating their tax liability on a transactional basis. As such, the over collection of transportation charges for the customer in transaction 1 would be offset against the under-collection of transportation charges for the customer in transaction 2. By utilizing this method, the

retailer would be allowed to exclude a total of \$30 from taxable gross receipts instead of \$25.

Table 2 Transportation Charges 2Q – 19XX

(A)	(B)	(C)	(D)
Transaction	Billed Amount	Actual Cost	Excludable
1	\$10	\$ 5	\$ 5
2	\$10	\$15	\$10
3	\$20	\$10	\$10
Total	<u>\$40</u>	<u>\$30</u>	<u>\$25</u>

Current Method

In Table 2, the retailer has billed their customers for transportation charges in excess of the actual cost during the quarter. The measure of tax to be excluded for the quarterly reporting period would be \$25. Again, this represents the lower of the billed transportation charge to the customer, or the actual cost of transportation on a transaction by transaction basis. As such, the \$5 excess-billed charge in transaction 1 and \$10 excess-billed charge in transaction 3 are not deductible and would be considered taxable gross receipts.

Proposed Method

Under the proposed method of aggregating transportation costs against billed amounts, the excludable amount of transportation charges would be \$30. This represents the actual cost of transportation for the quarter. The \$10 difference between the amount billed and the actual transportation cost would be considered taxable gross receipts for the reporting period.

V. Staff Recommendation

A. Description of the Staff Recommendation

Staff recommends no changes be made to the current interpretation of Regulation 1628 as it applies to the statutory exemption for transportation charges. Under current statutes, sales and use tax transactions are accounted for on a transaction by transaction basis. As such, it would not be equitable for retailers to be allowed to offset their overcharges for delivery to one customer against undercharges for delivery to another customer in order to determine deductible transportation charges.

B. Pros of the Staff Recommendation

- Does not require legislative action or revision to existing regulations.
- Maintains consistency with the application of tax to retail sales on a transaction by transaction basis.
- Does not require any change in reporting method for taxpayers.

C. Cons of the Staff Recommendation

- Retailers may conclude that the current method of accounting for transportation charges on a transactional basis is burdensome and costly, as the retailer may not be able to fully deduct their actual delivery costs to independent carriers.

D. Statutory or Regulatory Change

- None. The staff recommendation is the current method of reporting.

E. Administrative Impact

- There is no administrative impact.

F. Fiscal Impact

- There is no anticipated cost or revenue impact.

G. Taxpayer/Customer Impact

- There is no anticipated taxpayer/customer impact.

H. Critical Time Frames

- There are no critical time frames.

VI. Alternative 1

A. Description

Amend Regulation 1628, Transportation Charges, to allow retailers to use an optional, aggregate reporting method for excluding transportation costs paid to independent carriers instead of accounting for billed transportation charges and

actual costs on a transactional basis. In situations where total billed transportation charges to customers exceed the actual cost of transportation within a quarterly reporting period, the excess amount billed would be considered taxable gross receipts.

B. Pros of Alternative 1

- This proposal would provide retailers with an alternative and a less time consuming method of accounting for transportation charges.
- In situations where the retailer's billed transportation charges are equal to or exceed actual costs, this proposal would allow retailers to fully deduct their actual transportation charges without taking into consideration whether they have undercharged their customers on an individual basis.

C. Cons of Alternative 1

- Requires legislative changes to be made to Section 6011, "Sales Price," and Section 6012, "Gross Receipts," prior to amending Regulation 1628, Transportation Charges, to avoid statutory conflicts with the regulation.
- The proposed optional reporting method creates an inconsistency in the application of tax by allowing taxpayers to calculate their tax liability using aggregate totals instead of on a transactional basis. This method allows retailers to ignore individual transactions in which they may have either overcharged or undercharged their customers for transportation costs by independent carrier.
- The proposed aggregate method of accounting for transportation charges would generate a minor tax loss by allowing the retailer to offset transportation overcharges to individual customers that were not previously deductible.
- Allowing quarterly filing taxpayers to aggregate their transportation charges and offset over-billings against under-billings within each quarter could provide a greater deduction than for those taxpayers who are required to file on a monthly basis. In periods where transportation over-billings have occurred, the longer a taxpayer has to report, the more likely it is to accumulate under-billed transportation charges with which to offset the over-billed amounts.
- Allowing retailers to offset over and under billed transportation charges between sales transactions could generate confusion as to the proper

application of tax on retail sales. The proposed aggregate method of accounting for transportation charges is inconsistent with the statutory interpretation that tax is applied on a transaction by transaction basis.

D. Statutory or Regulatory Change

- If the Board chooses to facilitate the proposed aggregate accounting method change for transportation charges, Regulation 1628 would have to be amended. However, prior to amending Regulation 1628, legislation would be required to amend Section 6011, "Sales Price" and Section 6012, "Gross Receipts" in order to avoid a conflict between the regulation and the controlling statutes.

E. Administrative Impact

- The cost to notify taxpayers would be absorbable.

F. Fiscal Impact

- Cost impact - Considered to be absorbable
- Revenue Impact - See attached revenue estimate dated May 27, 1998

G. Taxpayer/Customer Impact

- Since the proposed accounting method change for transportation charges is optional, only those retailers electing to use the new method would be affected.
- Retailers who consistently undercharge their customers for delivery by independent carrier may experience limited tax relief due to the offset provision. Retailers who undercharge some customers and overcharge other customers would also receive some benefit.

H. Critical Time Frames

- There are no critical time frames.

Prepared by: Sales and Use Tax Department
Program Planning Division

Current as of June 8, 1998
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BOARD OF EQUALIZATION
REVENUE ESTIMATE**REGULATION 1628 - TRANSPORTATION CHARGES APPLICATION OF
TAX TO DELIVERY CHARGES****Alternative Proposal**

This alternative proposal would amend Sales and Use Tax Regulation 1628, Transportation Charges, to allow retailers the option to exclude from taxable revenue the aggregate amounts paid to independent carriers for delivery, on a quarterly basis, in lieu of accounting for deductible transportation charges on a transaction by transaction basis.

Background, Methodology, and Assumptions

Currently, charges for transportation by facilities other than those of the retailer, i.e. independent carriers, are excluded from the measure of the sales tax if they are separately stated on the purchaser's invoice, are for transportation directly to the purchaser, and do not exceed the cost to the retailer. Any portion of the delivery charge invoiced to the purchaser that exceeds the retailer's cost is not excludable from the measure of tax. Also, any portion of the retailer's cost that is more than the amount separately stated on the purchaser's invoice is not excludable from the measure of tax. Therefore, the lesser of the actual cost or the amount separately stated on the purchaser's invoice is excludable from taxable gross receipts measured on a transaction by transaction basis.

The alternative proposal would allow retailers the option to deduct the lesser of aggregate transportation costs billed by independent carriers during a quarterly period or the aggregate of the amounts separately stated on purchasers' invoices for the period. If the actual cost is less than or equal to the amount stated on the invoice for all transactions during a period this proposal would not result in a change in tax from that computed under the current regulation. Similarly, if the actual cost is always more than or equal to the amount on the invoice, no change would result. The potential tax change results from being able to offset overbillings and underbillings on individual transactions, if both exist during a reporting period.

Revenue Estimate

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The alternative proposal would make the computation of the transportation charges easier for the retailer. Rather than having to compute the proper amount of the transportation charges to exclude from the taxable gross receipts on a transaction by transaction basis, the retailer would be able to exclude the lesser of the aggregate actual cost of transportation or the aggregate delivery charges billed to customers within a period. Also, there would be no cases where the retailers would be required to pay more tax under the alternative proposal than they are paying under the current method, while there would be cases where the retailer's sales tax liability would be less under the alternative proposal. Therefore, we assume that, even though the revised reporting method would be optional, it would be in the retailer's best interest to use the revised reporting method.

Little data regarding the different means of reporting transportation charges is available, but from audit experience in this area, the staff of the Sales and Use Tax Department is of the opinion that the revenue effect of this proposal is limited.

Revenue Summary

Based on discussions with program staff, it is estimated that the revenue loss for the alternative proposal would be less than \$1 million.

Preparation

This revenue estimate was prepared by Jeff Reynolds, Statistics Section, Agency Planning and Research Division. This revenue estimate was reviewed by Ms. Laurie Frost, Chief, Agency Planning and Research Division and Mr. Dennis Fox, Program Planning Manager, Sales and Use Tax Department. For additional information, please contact Mr. Reynolds at (916) 445-0840.

Current as of May 27, 1998

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Committee Discussion

At the request of Board Member Klehs, staff met with representatives from the American Institute of Architects and the American Society of Architectural Perspectivists to clarify the sales tax status of these two groups. The industry representatives agreed with staff's position that in general architects are service providers and are not required to hold seller's permits in regard to the tangible personal property that is incidentally transferred to their clients in the course of a contract. By contrast, architectural perspectivists are akin to graphic artists in that they are generally considered retailers of the architectural renderings contracted for by licensed architects or land developers. Staff requested permission to clarify this distinction through articles placed in industry and Board publications, and by drafting an amendment to Regulation 1506, Miscellaneous Service Enterprises. In response to a question from Mr. Kurt Cooknick of the American Institute of Architects, staff affirmed that this opinion was not a change in Board position, and that industry should bring to staff's attention any pending audit determinations that appear contrary to this opinion.

Committee Action/Recommendation

The Committee approved the staff recommendation to draft clarifying language for Regulation 1506 in regard to architects and architectural perspectivists.

Agenda Item: Application of Tax on Delivery Charges

Issue

Should Regulation 1628, Transportation Charges, be amended to allow retailers the option to exclude from taxable revenue the aggregate amounts paid to independent carriers for delivery charges, on a quarterly basis, in lieu of accounting for deductible transportation charges on a transaction by transaction basis?

Committee Discussion

Mr. Gary Jugum explained this issue, and affirmed that staff's recommendation to maintain the Board's current interpretation of Regulation 1628 in regard to delivery charges, that is, for each delivery, any portion of the delivery charge which exceeds the retailer's cost is includable in taxable gross receipts. Mr. Frank Julian, representing Federated Department Stores, explained the difficulties encountered by retailers in applying these guidelines, particularly when, at the time of the sale, the retailer often does not know the actual cost to be incurred for delivery.

Committee Action/Recommendation

Upon the motion of Mr. Andal, the Committee encouraged industry representatives to draft proposed legislation to amend the Revenue and Taxation Code for review. The Committee agreed to support in concept legislation which would provide a statutory basis for allowing an exemption for delivery charges.

Approved: /s/ Ernest J. Dronenburg, Jr.

HONORABLE ERNEST J. DRONENBURG, JR.,
Committee Chair

/s/ E.L. Sorensen, Jr.

E. L. Sorensen, Jr., Executive Director

BOARD APPROVED

at the June 25, 1998 Board Meeting

/s/ Janice Masterton

Janice Masterton, Chief
Board Proceedings Division